FACULTY OF ECONOMICS
ANDALAS UNIVERSITY

THESIS

THE IMPACT OF BOARD OF DIRECTOR SIZE, CONCENTRATED OWNERSHIP, BANKS' AGE AND CAPITAL STRUCTURE ON INDONESIAN BANKING SECTOR PERFORMANCE

By:
Nicky Oktaria
03 153 017

ACCOUNTING DEPARTMENT

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ABSTRACT

This study observes about the impact of Debt to Equity Ratio as a part of capital structure decision in Banking companies, Board of Director Size and Concentrated Ownership on Banks' Performance measured by using Return on Assets (ROA), Return On Equity (ROE) listed in Jakarta Stock Exchange (JSX) in 2002-2004 with Banks' Age as the moderating variable. Results show indicates insignificant influence of Board of Director Size and Concentrated Ownership, but there is a significant influence of capital structure. These results suggest that the capital structure has influence to company value.

Keywords: corporate governance, agency theory, board of directors' size, concentrated ownership, banks' age, return on assets, return on equity, BOPO.

Chapter I

INTRODUCTION

1.1 Background

Changes in the macroeconomic environment lead corporate governance to be a critical- issue in all across countries in the last decade. And as combined with East Asian economic crisis in the late 1997, as the most affected countries, Indonesia is pressured to improve the corporate governance practices in Indonesia. As reported both the by Asian Development Bank (ADB) and the International Monetary Fund (IMF), the crisis to be a result of uneffectiveness mechanism of Board of Director and Audit Committee monitoring in order to protect the interest of shareholders and lack of professionalism in organizing the corporation. Large corporate failures and financial scandals such as Enron Corporation and World Com in USA, HIH Insurance Company Ltd and One-Tell Pty Ltd in Australia and Parmalat in Italy in beginning of 2000, have focused attention on the importance of corporate governance. In other words, less of transparency in corporate governance and the intervention of large shareholders in firm's management will create conflict interest.

The role of Corporate Governance in recovering the economic crisis in Indonesia is needed absolutely, because Corporate Governance system should provide effective protection for shareholders and creditors, so that they can assure themselves of getting a proper return on investment. Corporate Governance can therefore be defined as : a set of rules that define the relationship between shareholders, managers, creditors, the government, employees and other internal and external stakeholders in respect to their rights and responsibilities, or the system by which companies are directed and controlled (Cadbury Committee of United Kingdom). The objective of Corporate Governance is to create added value to the stakeholders. By applying Corporate Governance to the companies, there are some benefits that could be gained such as easier to raise capital, lower cost of capital, improve business and economic performance, and create environment conducive to the efficient and sustainable growth of the corporate sector (FCGI Publication 2006).

Banks and other financial intermediaries were at the heart of the Asian financial crisis. The deterioration of their asset portfolios–largely due to distorted credit management–was one of the main structural sources of the crisis. Hence, because bank is the most highly regulated firms, so that governance practices should be different with companies in non-financial sector (Lukviarman, 2004). To a large extend, this problem was the result of poor corporate governance in the countries' banking institutions and industrial groups. This poor corporate governance, in turn, was very much attributable to the relationships among the government, banks, and big businesses as well as the organizational structure of businesses. In some countries, banks were part of larger family-controlled business groups, and were abused as a tool of maximizing the family interests rather than the interests of all shareholders and other stakeholders. In other cases where private ownership concentration was not allowed, the banks were heavily intervened with and controlled by the government even without any ownership share. Understandably, in either case, corporate governance was very poor. The symbiotic

CHAPTER V

CONCLUSION

5.1. Conclusion

The purpose of the study is to investigate the relationship between corporate governance mechanisms, capital structure, age and banks' performance. Corporate governance mechanisms were focused on Board of Director Size and Concentrated Ownership. The studied organizations were Indonesian banking industries. Since the goal of the corporation changed into shareholder wealth maximization, it will be interest of investigating the factors that might influence return on asset (ROA) and return on equity (ROE). ROA and ROE has a close relationship to the corporation's value. It is also important to evaluate the efficiency of the company, mainly using BOPO indicator.

The study used ROA, ROE, and BOPO as dependent variables; board of director size, concentrated ownership, bank's age and capital structure are independent variables. Overall, this study found several important points. First, board of director size, concentrated ownership, banks' age has insignificant influence on ROA, ROE, and BOPO. Second, on the other hand, capital structure has significant influence on ROA, ROE, and BOPO. Third, board of director size, concentrated ownership, banks' age and capital structure as a group can explain 64.5% (ROA), 84.5% (ROE) and 69% (BOPO), of banks' performance in Indonesia

The implication of this study for banking industry in Indonesia is in managing their financial leverage, firms could consider about the using of debt. Generally, the using of debt will increase the ROA, ROE and BOPO. It is also has to be considered that age

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